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Consultation Paper on the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping) Rules

Dear Sir/Madam:

State Street Corporation (“State Street”) appreciates the opportunity to comment on the Consultation Paper on the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping) Rules jointly published by the Hong Kong Monetary Authority (“HKMA”) and the Securities and Futures Commission (“SFC”) on 18 July 2014 (the “Paper”). The Paper sets out proposals for mandatory reporting and related record keeping obligations. State Street has set out in this submission our comments to key questions raised in the Paper.

Headquartered in Boston, Massachusetts, with branches and subsidiaries throughout the APAC region, State Street specializes in providing institutional investors with investment servicing, investment management and investment research and trading. With USD 27.47 trillion in assets under custody administration and USD 2.38 trillion in assets under management, State Street operates in 29 countries and in more than 100 markets worldwide.¹ Since our entry into the Asia-Pacific (APAC) region more than 25 years ago, today we have more than 3,900 employees in ten jurisdictions in Australia, Brunei, China, Hong Kong, India, Japan, Malaysia, Singapore, South Korea, and Taiwan, servicing our clients throughout the region. In 1982, State Street opened its Hong Kong office, which now serves as the regional headquarters.

¹ As of March 31, 2014.

Please find below State Street's comments in response to specific questions raised in the Paper.

Q2. Do you have any comments or concerns about the proposed types of IRS and NDF that will be subject to the mandatory reporting obligation in the initial phase of implementation?

We appreciate the main focus of the Paper is on mandatory reporting of NDFs in the foreign exchange (FX) markets. However, in anticipation of expanded scope of reportable products for FX derivatives, we recommend the current definition of "spot contract" in the Securities and Futures (Amendment) Ordinance 2014 be expanded to cover: 1) foreign exchange contracts which are executed as a need for settlement of securities; and 2) foreign exchange contracts that are entered into as a result of other securities related transaction, such as corporate actions, income repatriation. These trades should be considered as bona fide spot transactions, but given that the settlement period of securities may differ depending on the local jurisdiction, a broadened interpretation of spots should be used.

We would like to note in particular the importance of including these two items noted above. Transactions described in 2) are effected for the purpose of receiving amounts in a foreign currency by way of dividend, coupon, corporate action or other securities related transactions as a result of holding securities. By definition, they are not entered into, and could not be entered into, for speculative purposes in order to profit from changes in FX rates and they are not intended in any way to be derivatives, and subjecting them to the reporting mandate would be misleading and would not provide meaningful additional protection to such parties.

It is also worth noting that for Dodd Frank reporting purposes, U.S. regulators have agreed that a foreign exchange transaction with a longer settlement period that is entered into solely to effect the purchase or sale of a foreign security is a bona fide spot transaction. In general, we agree with industry's view that the same should apply to Hong Kong in order to achieve a harmonized regime. (For your reference, please see attached summary on the current definition of "spot" under Dodd Frank.)

Q4. Do you have any comments or concerns about how the terms "conducted in Hong Kong" and "affiliate" are proposed to be construed, or how this limb of the reporting obligation is cast? In particular, do you have concerns as to how this proposal might impact entities that keep a global book?

We understand that HKMA and SFC will be putting together FAQs to address the reporting mandate around electronic trading and we look forward to receiving those.

Q9. Do you have any comments or concerns about how the reporting obligation will apply to funds? Do you envisage that funds may face practical difficulties in complying with this obligation? If so, please provide details of the specific difficulties envisaged.

The Paper indicates a transaction is reportable by both a fund and its fund manager or sub-manager – e.g. the fund is a Hong Kong person and is managed by an AI or LC. In such cases, the fund will be exempted from reporting by the virtue of the exemption under Rule 20 of the Draft

Rules. However, this exemption will not apply where the fund is a Hong Kong person but is not managed by an AI or LC. In this case, the reporting obligation will remain with the legal owner of the fund (e.g. the trustee or partners if the fund is established as a trust or partnership).

Therefore, we recommend that the exemption for reporting by funds be extended to where the fund is a Hong Kong person and is managed by a fund manager, sub-manager or investment adviser who is based in a jurisdiction with an inspection regime acceptable to the SFC as stipulated in 5.1 of the Code on Unit Trusts and Mutual Funds. The transactions for the fund will be reportable by the fund manager, sub-manager or investment adviser.

Also, if the reporting obligation remains with the legal owner of the fund (e.g. the trustee) and the exemption does not apply, we recommend imposing a requirement on the fund manager to sufficiently furnish the trustee with the relevant data required for the reporting and that the trustee may delegate the reporting to the fund manager. As part of the fund manager's investment responsibility, it is their primary obligation to maintain and calculate the threshold and exposure, among others, for the OTC derivatives transactions.

Q14. Do you have any comments or concerns about the proposed exemptions and reliefs, and the criteria for triggering them?

We suggest that OTC derivative transactions executed with governments, central banks and governmental agencies ("Specified Entities") to be exempted from the reporting mandate in Hong Kong, with such exemption being applicable to both the Specified Entity and also the counterparty to the Specified Entity under the OTC derivative transaction. This approach is adopted by the Monetary Authority of Singapore ("MAS") where MAS provided exemptions from reporting obligations for the Specified Entities and also the counterparties with which trade such entities transact (see attachment). Due to the special status enjoyed by the Specified Entities, our expectation is that consent from such Specified Entities for reporting will unlikely to be forthcoming. Also, it would be beneficial for Hong Kong and Singapore to have a harmonized approach because many financial institutions have regional headquarters and major presence in these two locations in the region.

Q20. Do you have any comments or concerns about how the concession period and grace period are proposed to operate?

We would appreciate an indication of when the Draft Rules are likely to be finalized in order for us to better prepare for compliance with the mandatory reporting regime in Hong Kong.

Q22. Do you have any comments or concerns about the proposed types of transaction information required to be reported for the purposes of the reporting obligation, or as to how these have been expressed in Schedule 2?

We seek further clarification on prior to the implementation of mandatory clearing for NDFs, in respect of "uncleared" NDFs, if reporting of subsequent events refers to anything other than New, Amendment, and Cancellation/Termination.

Q25. Do you have any comments or concerns about the proposals on masking counterparty information under certain circumstances as a temporary measure?

In relation to reporting counterparty identity information, consistent with the practice adopted by overseas regulators within the Asia Pacific region, it is recommended that the relief described in Draft Rule 31(1)(b) be extended to new transactions (rather than historical transactions) provided that a reporting entity has demonstrated good faith effort in obtaining counterparty consent and despite such efforts, it has not been able to obtain the requisite consent. Further, we would appreciate if the HKMA and SFC could provide an indication of the publication timeline for the initial list of designated jurisdictions in which the reporting of counterparty identity details is prohibited.

Thank you again for the opportunity to comment on the important matters raised within this consultation paper. Attached you will find State Street's summary of the Dodd-Frank definition of foreign exchange spot and regulatory language defining spot as well as the Fourth Schedule of Exempted Persons in the Securities and Futures Amendment regulations issued by MAS. Please feel free to contact

, should you wish to discuss State Street's submission in greater detail.

Sincerely,

State Street Bank and Trust Company

CC: Fourth Schedule to the Securities and Futures (Reporting of Derivatives Contracts) by MAS
Dodd-Frank Definition of FX Spot
Regulatory Language Defining Spot



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Attachment: *Fourth Schedule to the Securities and Futures (Reporting of Derivatives Contracts) (Amendment) regulations 2014 issued by MAS*

FOURTH SCHEDULE

Regulation 10

EXEMPTED PERSONS

1. The Government
2. Any statutory board established under any written law
3. Any central bank in a jurisdiction other than Singapore
4. Any central government in a jurisdiction other than Singapore
5. Any agency (of a central government in a jurisdiction other than Singapore) that is incorporated or established, in a jurisdiction other than Singapore, for non-commercial purposes
6. Any of the following multilateral agencies, organisations or entities:
 - a. the African Development Bank
 - b. the Asian Development Bank
 - c. the Bank for International Settlements
 - d. the European Bank for Reconstruction and Development
 - e. the European Economic Community
 - f. the European Investment Bank
 - g. the Inter-American Development Bank
 - h. the International Bank for Reconstruction and Development (World Bank)
 - i. the International Finance Corporation
 - j. the International Monetary Fund

Source: <http://www.mas.gov.sg/~media/MAS/News%20and%20Publications/Consultation%20Papers/CP%20FX%20regs.pdf>

Definition of FX Spot for the Dodd-Frank Act Reforms

| | What is a “swap”? | What is excluded spot? |
|--|--|---|
| <p>CFTC/SEC Interpretive Guidance</p> <p>(Source: Product Definition final rule)¹</p> | <p>Swaps as defined in the CEA</p> <p>Include:</p> <ul style="list-style-type: none"> - Cross-currency swap; - Currency option, foreign currency option, foreign exchange option and foreign exchange rate option; - Foreign exchange forward; - Foreign exchange swap; - Forward rate agreement; and - Non-deliverable forward involving foreign exchange. | <p>A spot transaction, in the context of foreign currency, typically settles within two business days after the trade date (T+2) or on the "customary timeline of the relevant spot market."</p> <p>Also: Spot includes a foreign exchange transaction that is entered into solely to effect the purchase or sale of a foreign security to be a bona fide spot transaction where certain conditions are met.</p> <p>Also: Securities conversion transaction as not leveraged, margined or financed within the meaning of section 2(c)(2)(C) of the CEA.</p> |
| <p>Federal Reserve (proposed)</p> | <ul style="list-style-type: none"> - Rolling spot forex transactions. - An agreement, contract, or transaction in foreign currency, that is offered or entered into by a banking institution with a person that is not an eligible contract participant and that is offered or entered into on a leveraged or margined basis, or financed by a banking institution, its affiliate, or any person acting in concert with the banking institution or its affiliate on a similar basis. | <ul style="list-style-type: none"> - A covered product that is actually delivered in 2 days. - A covered product that is not offered on a leveraged or margined basis. |

¹77 Fed. Reg. 48208 (August 13, 2012)

Regulatory Language Defining Spot

1 CFTC and SEC: Final Rule on Swap Product Definitions²

"(c) Interpretation Regarding Foreign Exchange Spot Transactions

The CEA generally does not confer regulatory jurisdiction on the CFTC with respect to spot transactions. In the context of foreign currency, spot transactions typically settle within two business days after the trade date ("T+2"). The accepted market practice of a two-day settlement for spot foreign currency transactions has been recognized by the CFTC and the courts.

The Commissions recognize that the new foreign exchange forward definition in the CEA, which was added by the Dodd-Frank Act and which applies to an exchange of two different currencies "on a specific future date," could be read to apply to any foreign exchange transaction that does not settle on the same day. Such a reading could render most foreign exchange spot transactions foreign exchange forwards under the CEA; as a result, such transactions would be subject to the CEA reporting and business conduct standards requirements applicable to foreign exchange forwards even if the Secretary determines to exempt foreign exchange forwards from the definition of "swap." The Commissions do not believe that Congress intended, solely with respect to foreign exchange transactions, to extend the reach of the CEA to transactions that historically have been considered spot transactions. **At the same time, however, the Commissions do not want to enable market participants simply to label as "spot" foreign exchange transactions that regularly settle after the relevant foreign exchange spot market settlement deadline, or with respect to which the parties intentionally delay settlement, both of which would be properly categorized as foreign exchange forwards, or CEA section 2(c)(2) transactions (discussed separately below), in order to avoid applicable foreign exchange regulatory requirements. [Emphasis added]**

Accordingly, the Commissions are providing an interpretation that a bona fide foreign exchange spot transaction, *i.e.*, a foreign exchange transaction that is settled on the customary timeline of the relevant spot market, is not within the definition of the term "swap." In general, a foreign exchange transaction will be considered a bona fide spot transaction if it **settles via an actual delivery of the relevant currencies within two business days. In certain circumstances, however, a foreign exchange transaction with a longer settlement period concluding with the actual delivery of the relevant currencies may be considered a bona fide spot transaction depending on the customary timeline of the relevant market. In particular, as discussed below, the Commissions will consider a foreign exchange transaction that is entered into solely to effect the purchase or sale of a foreign security to be a bona fide spot transaction where certain conditions are met.**

² Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping 77 FR 48208, 48256 – 48257 (August 13, 2012) (Final Rule).

The CFTC will consider the following to be a bona fide spot foreign exchange transaction:

An agreement, contract or transaction for the purchase or sale of an amount of foreign currency equal to the price of a foreign security with respect to which

- (i) the security and related foreign currency transactions are executed contemporaneously in order to effect delivery by the relevant securities settlement deadline and
- (ii) actual delivery of the foreign security and foreign currency occurs by such deadline (such transaction, a “Securities Conversion Transaction”).

For Securities Conversion Transactions, the CFTC will consider the relevant foreign exchange spot market settlement deadline to be the same as the securities settlement deadline. As noted above, while the CFTC will look at the relevant facts and circumstances, it does not expect that an unintentional settlement failure or delay for operational reasons or due to a market disruption will undermine the character of a bona fide spot foreign exchange transaction as such.

The CFTC also will interpret a **Securities Conversion transaction as not leveraged, margined or financed within the meaning of section 2(c)(2)(C) of the CEA**. While it is possible to view the fact that the buyer of a currency in such a transaction does not pay for the currency until it is delivered as leverage (in that the buyer puts nothing down until taking delivery, thus achieving 100% leverage) or a financing arrangement, the CFTC does not interpret it as such for purposes of CEA section 2(c)(2)(C). Congress recognized that settlement of bona fide spot foreign exchange transactions typically takes two days. The fact that Congress expressly excluded these types of bona fide spot foreign exchange transactions does not mean that Congress intended to subject Security Conversion Transactions to regulation under the retail foreign exchange regime. For the foregoing reasons, the CFTC will interpret a Securities Conversion Transaction as not leveraged, margined or financed within the meaning of section 2(c)(2)(C) of the CEA.

2 Federal Reserve Retail Foreign Exchange Final Rule Excerpt³

First, certain transactions in foreign currency are not “retail forex transactions,” and therefore are not subject to the prohibition in section 742(c)(2) of the Dodd-Frank Act. For example, a “spot” forex transaction where one currency is bought for another and the two currencies are exchanged within two days is not a “future” and would not meet the definition of a “retail forex transaction,” since actual delivery occurs as soon as practicable. Similarly, a “retail forex transaction” does not include a forward contract with a commercial entity that creates an enforceable obligation to make or take delivery, provided the commercial counterparty has the ability to make delivery and accept delivery in connection with its line of business. In addition,

³ Retail Foreign Exchange Transactions (Regulation NN), 78 Fed. Reg. (April 9, 2013)

“retail forex transaction” does not include an “identified banking product” or a part of an “identified banking product,” as defined in section 401(b) of the Legal Certainty for Bank Product Act of 2000. Finally, the definition does not include transactions executed on an exchange or designated contract market.

Second, the proposal would cover rolling spot forex transactions (so-called *Zelener* contracts), including without limitation such transactions traded on the Internet, through a mobile phone, or on an electronic platform. A rolling spot forex transaction normally requires delivery of currency within two days, like spot transactions. However, in practice, these contracts are indefinitely renewed every other day and no currency is actually delivered until one party affirmatively closes out the position. Therefore, the contracts are economically more like futures than spot contracts, although some courts have held them to be spot contracts in form. For this reason, the proposal regulates these rolling spot forex transactions as retail forex transactions when conducted with a person that is not an eligible contract participant.

This section defines several terms by reference to the CEA, including “eligible contract participant.” Foreign currency transactions with eligible contract participants are not considered retail forex transactions and are therefore not subject to this rule. The proposed definition covers a variety of financial entities, governmental entities, certain businesses, and individuals that meet certain investment thresholds.

3 Treasury

The Treasury Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act does not define “spot.”